A REPORT OF THE METROPOLITAN TORONTO ADVISORY TASK FORCE ON ASSESSMENT REFORM

REASSESSMENT AT THE TIME OF SALE

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REPORT OF THE SUB-COMMITTEE ON REASSESSMENT AT TIME OF SALE

June, 1987

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1. INTRODUCTION

1.1 Establishment of the Sub-Committee

On October 28 and 29, 1986, the Metropolitan Council endorsed, in principle, market value reassessment for Metropolitan Toronto. Metropolitan Council also approved various motions requesting the Metropolitan Toronto Advisory Task Force on Assessment Reform to undertake further study of three particular mechanisms which would update market values in a different manner than under the proposed Metro wide Section 63 market value program. Specifically, Metro Council directed that:

the Metropolitan Toronto Advisory Task Force on Assessment Reform study and report to the Special Committee of Members of Council on the following:

(i) a study of the feasibility of implementing the aforementioned reassessment reform on the basis of an ongoing reassessment of properties at the time of sale;

(ii) the applicability of 1980 reassessment adjustments when a building is enlarged with additional square footage being more than 10 percent; and

(iii) the applicability of 1980 adjustments where buildings are renovated, the total cost of such renovations being more than 33 1/3 percent of the estimated value of the building, such renovation being aggregated over the period of time one owner remains in possession.

Consequently, the Advisory Task Force created the Sub-Committee on Reassessment Issues (the Sub-Committee) to examine the applicability of implementing market value assessment reform using the various mechanisms identified by Council. The three reassessment mechanisms reflecting the intent of the above recommendations are as follows:

(i) **Reassessment at Time of Sale:** the assessed value of a property is updated to the value that it sells for in the open market; the new owner pays taxes on the updated assessed value.

(ii) **Reassessment at Time of Expansion:** the assessed value of a property is updated to current market value when the associated building is enlarged more than ten percent of its original size.

(iii) **Reassessment at Time of Renovation:** the assessed value of a property is updated to current market value when its associated building is renovated at a cost of more than 33 1/3 percent of its estimated value; such renovations being aggregated over the period of time one owner remains in possession.

The Sub-Committee was comprised of representatives from the Ministry of Municipal Affairs, the Ministry of Revenue, the City of Toronto and Metropolitan Toronto (see Exhibit 1). The conclusions of this report are based on analysis of the experiences of American municipalities with the time of sale concept, as well as the simulation of a time of sale reassessment in selected areas in Metro Toronto.

The Sub-Committee's view was that the conclusions drawn with respect to reassessment at time of sale can be inferred for the other two reassessment schemes as the implications arising from the analysis of reassessment at time of sale hold true for these two mechanisms as well.

EXHIBIT 1

REASSESSMENT AT TIME OF SALE SUB-COMMITTEE

MEMBERSHIP

Ed Zamparo	Metro Toronto (Sub-Committee Chairman)

Members Listed in Alphabetical Order

Mr. Doug Barnes	Ministry of Municipal Affairs
Ms. Audrey Birt	City of Toronto
Mr. Ed Hanowski	Ministry of Revenue
Mr. Almos Tassonyi	Ministry of Municipal Affairs
Mr. William Wu	Ministry of Revenue

2. THE TIME OF SALE CONCEPT

Reassessment at time of sale is a method whereby properties are reassessed only when they are sold. Accordingly, the assessment on a property remains frozen until such time as the property is sold, whereupon the property is reassessed to market value. Under this scheme, there would be no immediate across-the-board increases or decreases in property assessments as featured under the proposed Metro wide Section 63 market value assessment program.

2.1 Reassessment Difficulties in California

There is no evidence of the practice of time of sale reassessment in Canada. There is, however, some limited application of this practice in the United States; the first and most relevant application being in the State of California.

Prior to 1978, property assessments in California were established as a percentage (25%) of market value with reassessments conducted every one or two years to keep market value estimates current. Property assessments were thereby permitted to rise and fall freely according to market conditions. This created widely fluctuating tax burdens as California law did not mandate compensating tax rate adjustments to provide constant tax revenues. As a result, each reassessment could mean violent and dramatic tax increases for property owners and, just as often, windfall tax gains for the municipalities. This situation led the taxpayers in California to revolt in 1978. This took the form of the passing of Proposition 13 to amend the State Constitution.

2.2 Time of Sale Reassessment as Part of Proposition 13

Among several other changes to property assessment and taxation included in Proposition 13, it introduced the concept of "reassessment at time of sale". Initially, all assessments were rolled back to 1975/76 market values. An

inflationary adjustment of 2 percent was established and applied to all property assessments annually, except those properties which sold and, therefore, would be reassessed to twenty-five percent of full market value (based on the sale price) in the year of their sale. These assessments would receive the annual 2 percent inflationary adjustment in the years following the sale, until such time as the properties were resold.

Major improvements, other than ordinary repairs and necessary replacements would lead to a re-evaluation of the improvement only. The two portions of the assessment would be combined and would continue to receive the annual two percent adjustment. Proposition 13 also provided that the annual taxes on any property be limited to one percent of the assessed property value, except where additional funds were required to service municipal debts.

The use of time of sale reassessment as the basis for Proposition 13 was primarily instituted in order to stabilize the annual oscillations in property taxes resulting from major fluctuations in the market. The application of time of sale reassessment in Metro Toronto, however, would be precipitated by the need to make property assessments more equitable. Despite this difference in the reasons for its application, the conclusions of time of sale reassessment experiment in California can be inferred for Metro Toronto.

3. CRITIQUE OF TIME OF SALE REASSESSMENT

The Sub-Committee considered the advantages and disadvantages of the time of sale method and concluded that its inherent problems far outweigh any of its perceived benefits. The basic advantage of this method is that it would limit the number of properties experiencing property tax increases, owing to reassessment, to those properties which sold during the year. Alhough the impact on property owners in total may be less under time of sale reassessment than under the proposed Metro wide Section 63 market value program, this advantage is more than offset by two major disadvantages. Reassessment at time of sale requires too much time to reassess all properties at comparable levels and it creates major inequities among properties - the reason for implementing market value assessment in Metro Toronto in the first place. The following sections discuss these shortcomings in greater detail.

3.1 Time Requirement

The whole process of reassessing properties on a regular basis under the practice of time of sale reassessment is deferred and spread over an indeterminable number of years. The presumption that most properties sell and that they sell at regular and frequent intervals is unsound. The Ministry of Revenue analysis indicates that approximately ten percent of all residential properties including resale properties, new homes and non-arm's length sales properties, sell annually. Theoretically, a complete reassessment should be accomplished within ten years. However, not all home owners would sell their homes within the ten years and these properties avoid reassessment and remain at their existing levels of assessment. Hence, a complete reassessment of all properties is unlikely to ever occur under this scheme.

3.2 Inequitable Treatment of Properties

The Sub-Committee cited several inequities resulting from the application of time of sale reassessment.

3.2.1 Inequities Introduced to Equitably Assessed Properties

The introduction of time of sale reassessment to a situation where similar properties are comparably and equitably assessed would result in the replacement of equal treatment of similar properties with unequal treatment of similar properties.

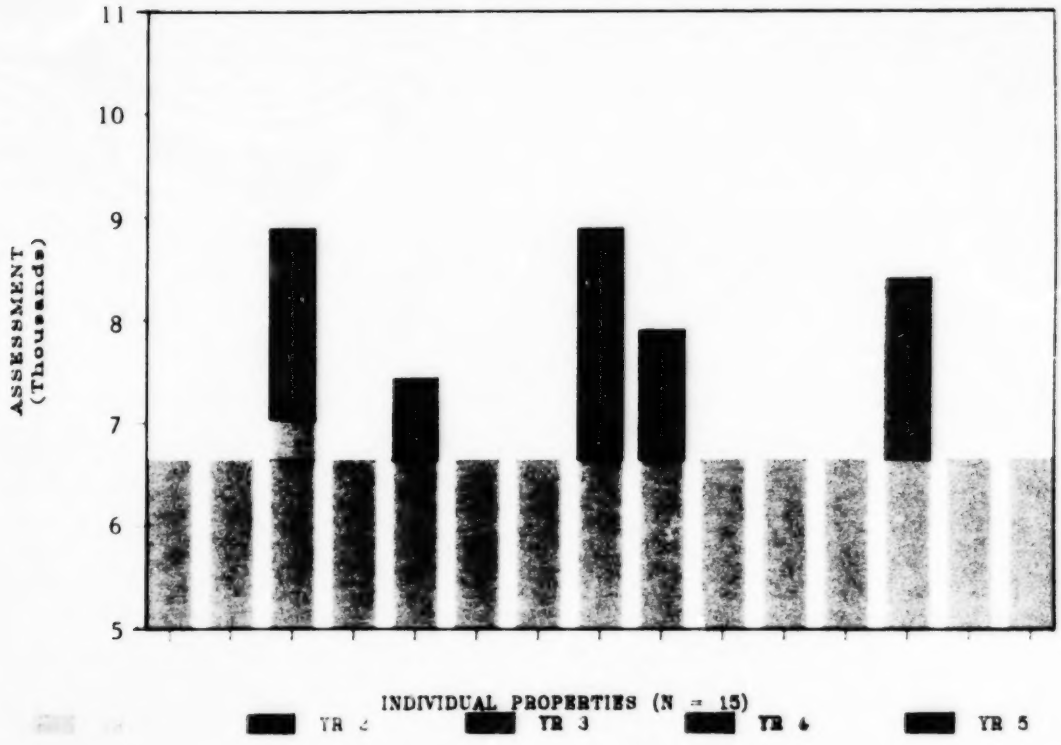
Properties which are sold in a given neighbourhood acquire increased assessed values relative to their neighbours. Some of these properties might be resold some years, hence, causing them to be even more highly assessed relative to those properties which have not been sold. At this point, similar properties which were previously comparably assessed would now each have different levels of property assessment. This situation is clearly inequitable. Even if a general two percent annual assessment increase is applied to all properties (except those which sold in that year) the effect would remain the same.

The inequitability in assessment that results from time of sale reassessment is best illustrated by a hypothetical example. Exhibit 2 shows what would happen with condominium units which are similar in construction and value and are equitably assessed before the method of time of sale is applied. The sale of condominium units over five years represented by the different colours, indicates how similar properties which sold would be assessed at higher market values than those properties which did not sell or which sold in different years.

On the other hand, high rise multi-residential apartment complexes rarely sell. Generally, these properties will be sheltered from reassessment. The result is a visible shifting of property taxes from this type of property to those which sell more frequently; namely, condominiums and other single-family dwellings.

EXHIBIT 2

THE EFFECT OF REASSESSMENT AT TIME OF SALE ON EQUITABLY ASSESSED PROPERTIES (CONDOMINIUMS)



3.2.2 Inequities Imposed on Inequitably Assessed Properties

Existing inequities among properties would be exacerbated under time of sale reassessment. For example, if one of the already over-assessed properties is sold, its reassessment at market value will further compound its over-assessment relative to other similar properties. Alternatively, the application of the time of sale method to similar properties with dissimilar assessments (e.g. some high, some average and some low), may cause the property with average assessment to rise to the high level, add to the already high assessment, raise the low assessment to the average, or lower the low assessment still further. Existing inequities would become compounded.

3.2.3 Inequities Imposed on Different Classes of Properties

Since residential properties tend to sell more frequently than industrial and commercial properties, the time of sale method would result in residential properties assuming a relatively higher percentage of assessment to value than their industrial and commercial counterparts. In addition, commercial and industrial properties are sold as part of the assets of a company and are not registered in the usual way as a real estate transaction. Thus, these properties may not be exposed to reassessment resulting in a further shifting of tax burden onto those properties which sell more frequently (i.e. residential properties). Also, due to the infrequent reassessment of these property classes, this method would introduce greater assessment disparities each time a property is sold.

3.2.4 Impact on Starter Homes

Starter type homes experience high demand and tend to be bought and sold more frequently than other residential properties. Accordingly, these homes will also be the most frequently reassessed. Consequently, young and lower income starter-type home owners will bear a disproportionately higher percentage of property taxes. This situation is particularly inequitable because newly constructed link houses, row type townhouses and other starter-type housing is currently being assessed at a higher percentage of market value.

3.2.5 Impact on Real Estate Market Activity

Distortions to the real estate market may arise from the practice of time of sale. Since each sale evokes an immediate reassessment, there may be a disincentive for property owners to sell their properties or to dispose of them in the conventional manner. Consequently, the real estate market may become more akin to non-arm's length transactions. The "shadow market" may become more active as property vendors and purchasers attempt to avoid anticipated higher property and land transfer taxes resulting from reassessment.

3.2.6 Lack of Standard of Comparison

Over time, and without general reassessments to recognize the differential market value rate of all properties, any property assessment and taxation system based on the time of sale method will be greatly impaired. While the proposed Section 63 market value assessment program provides ratepayers with a standard of comparison which is impartial, understandable and stable, such a "hit and miss" application will further distort existing inequities and home owners' abilities to compare their assessments with their neighbours, or other similar properties. This method of reassessment would require any assessment review to impose further equalization and adjustment in order to align the disparate values, causing further confusion.

3.3 Conclusions

The time of sale method has limited utility because it provides for reassessment on a limited scale. It directly affects only those properties which are sold while sheltering properties not sold from their appropriate assessments. The end result of this method is a reassessment process which imposes major inequities on those properties sold and/or compounds an already non-equitable assessment base. This method cannot ensure a reassessment of all properties over time.

4. SIMULATION OF TIME OF SALE REASSESSMENT IN METROPOLITAN TORONTO

The Ministry of Revenue provided the Sub-Committee with a simulation of the operation of the time of sale reassessment in Metro Toronto. The simulation was based on an analysis of sales data carried out in three residential areas in Metro Toronto. A total of 70 residential properties were selected as representative samples in the three neighbourhoods. Over a five-year period covering 1981-1985, a total of 24 different properties or 34 percent of the actual sample were sold. During this same time period, real estate studies indicated that house prices in Metro Toronto increased at an average annual rate of six percent. The property sales over the five-year period are represented by the different colours and indicate how similar properties, when sold, are reassessed at higher levels of market value than those properties which did not sell, or which sold in different years.

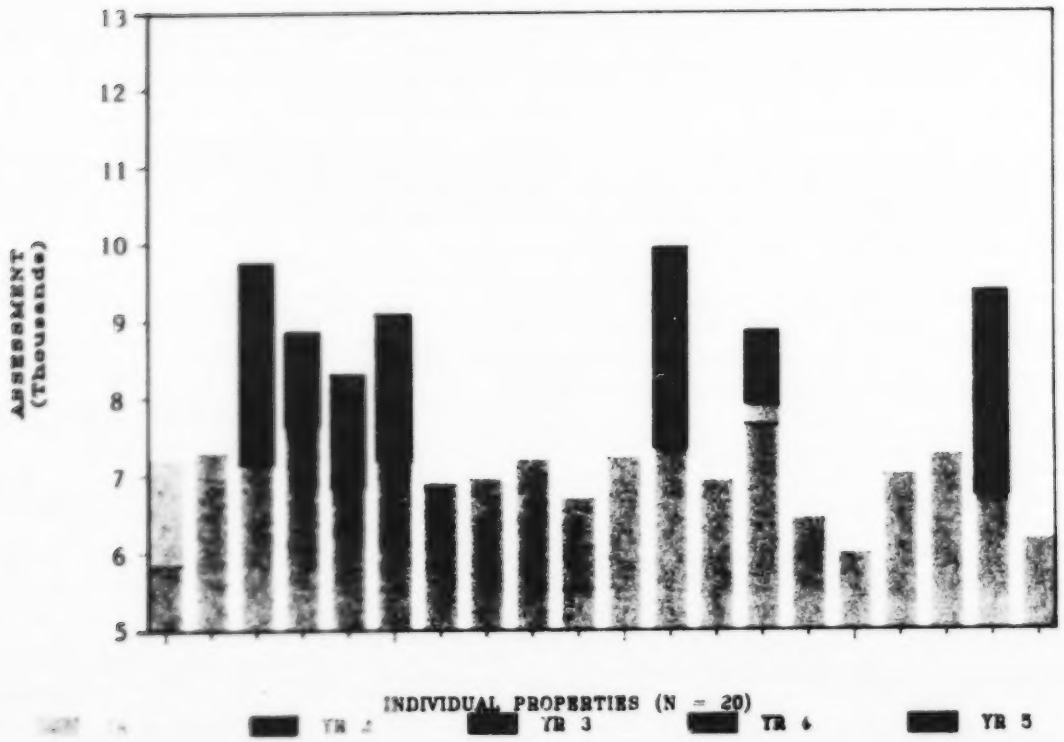
4.1 Sampled Neighbourhoods

Neighbourhood 1

This is an example of a suburban neighbourhood consisting of approproximately forty year-old residences. Over time, many home owners have undertaken renovations, improvements and additions to their homes. The effect of these improvements on the market value of the properties is realized when the properties are sold. The reassessment of homes at time of sale over the five-year period, in this neighbourhood, is illustrated in Exhibit 3. It is evident from Exhibit 3 that the assessed values of the sampled properties are becoming less equitable. Those properties sold reflect high levels of market value assessment relative to those properties not sold.

EXHIBIT 3

THE EFFECT OF REASSESSMENT AT TIME OF SALE
IN NEIGHBOURHOOD 1



Neighbourhood 2

This neighbourhood represents a standard subdivision that is less than 10 years old. The results of applying the time of sale method in this particular neighbourhood are presented in Exhibit 4. The data for this area shows fewer discrepancies in current assessment levels. This is primarily attributable to the similar age and housing type of the sampled properties. Most of the original owners are still residing in their homes. In time, this neighbourhood profile could possibly ressemble the profile of neighbourhood 1 as some owners will begin to modify their homes and eventually sell them.

Neighbourhood 3

This is a downtown residential area with predominantly 70 to 100 year-old housing of various types. The results of time of sale reassessment in this neighbourhood are shown in Exhibit 5. The data for this particular area shows substantial discrepancies in assessment levels. The difference in levels of assessment between properties sold and not sold indicates how unfairly time of sale reassessment treats properties. Those properties that sold within the five-year period attracted a greater tax burden while those properties that didn't sell continue to enjoy their existing 1940-level assessments.

4.2 Summary

The three samples serve to illustrate some of the effects of time of sale reassessment. The selected properties in each of the three neighbourhoods experienced discrepancies in their levels of assessment. These levels of discrepancies were not reduced over the five years, in fact, it can be argued that they were increased.

EXHIBIT 4

THE EFFECT OF REASSESSMENT AT TIME OF SALE IN NEIGHBOURHOOD 2

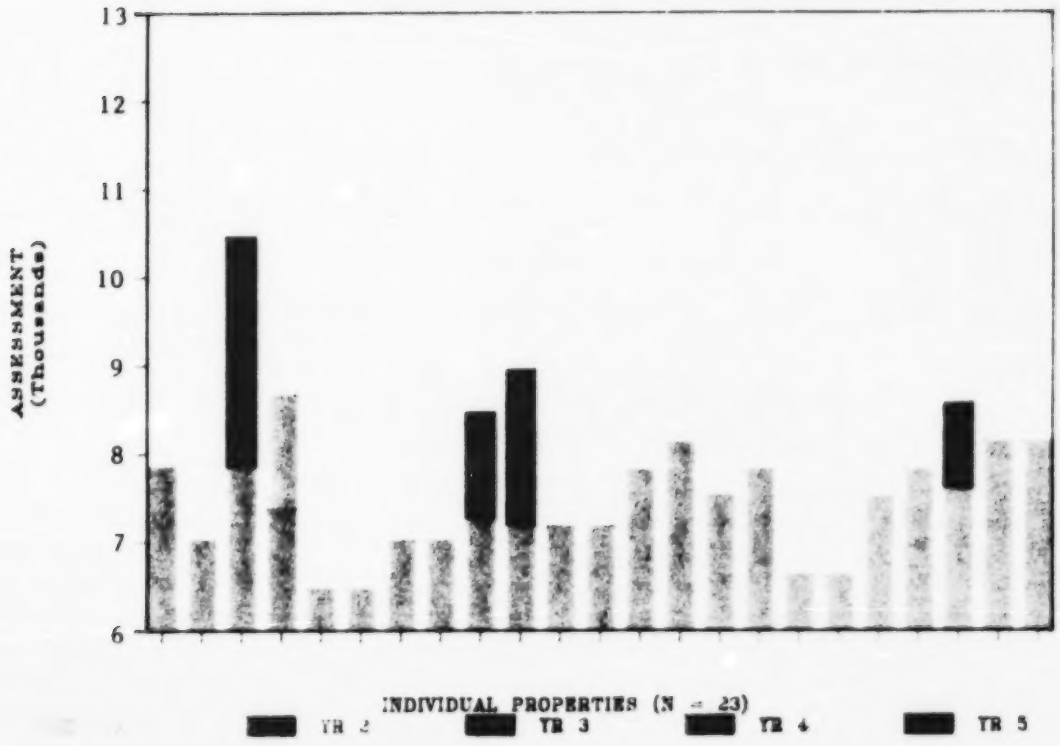
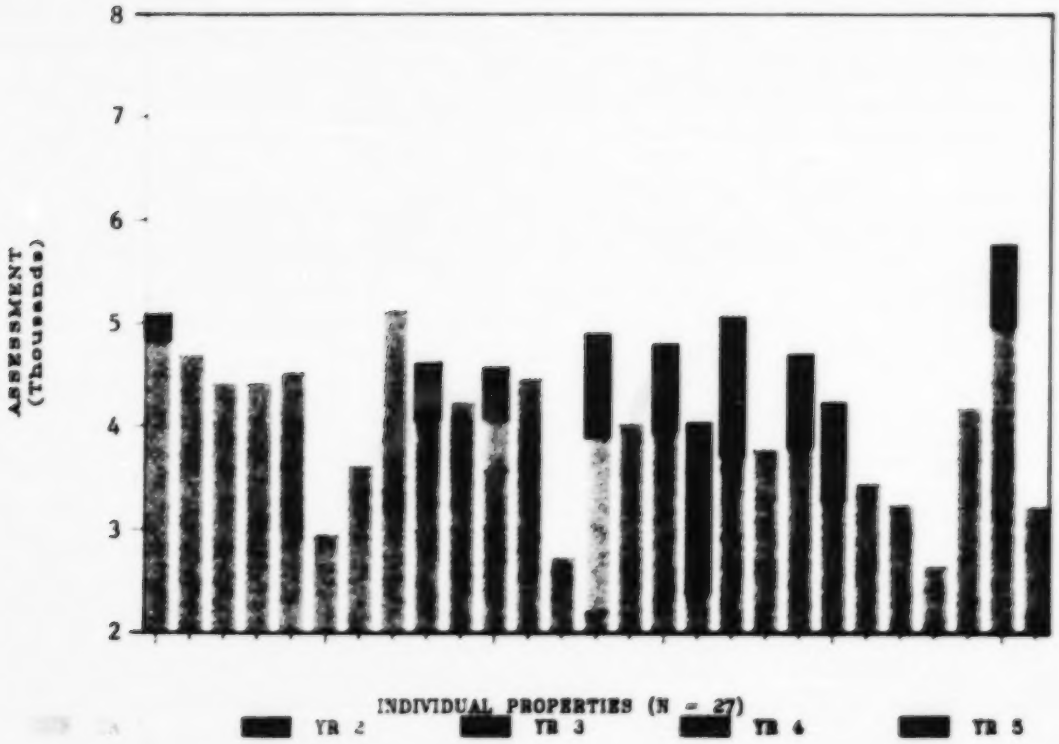


EXHIBIT 5

THE EFFECT OF REASSESSMENT AT TIME OF SALE IN NEIGHBOURHOOD 3



5. CONCLUSIONS

5.1 Implications for Other Reassessment Mechanisms

The analysis of reassessment at time of sale provides valuable insight into the inherent problems of both reassessment at time of expansion and reassessment at time of renovation. Both reassessment mechanisms are plagued by the time dilemma and some of the inequities experienced by the time of sale method.

Essentially, both assessment mechanisms are rendered ineffectual by the amount of time that they require to ensure reassessment of all properties. The presumption that home owners continually undertake modifications of some sort to their properties is unfounded. At best, these two mechanisms could only achieve a partial reassessment.

The major inequity introduced by the two reassessent mechanisms is the unfair treatment of properties undergoing some sort of modification in excess of some defined level, while sheltering other properties. This approach towards updating market value assessment does not deal with all properties simultaneously as does Section 63 market value. Much like the time of sale method, the "hit and miss" application implied by these two mechanisms provides little that will correct present inequities. Furthermore, both mechanisms exacerbate one of the criticisms of the property tax; that it penalizes property owners who undertake improvements to their property.

In addition, both mechanisms include provisions for ceilings on the amount of physical space that can be added or the cost of renovating a property. Property owners will seek to avoid reassessment by undertaking improvements that are just under these allowable limits. Without a general reassessment to recognize these modifications, the differential market values of properties will become impaired over time.

It has been noted that the three mechanisms addressed by the Sub-Committee attempt to provide, in a single effort, some form of updating market values tha does not impact taxpayers as greatly as expected under Metro wide Section 63 reassessment. However, the effectiveness of these three methods is seriously compromised by their attempt to shelter taxpayers from any such increases. Conversely, Metro wide Section 63 reassessment first establishes equitable market values and then through the use of other means, if Metro Council so desires, it can provide assistance to those individuals expecting increases.

In conclusion, assessment at time of sale, reassessment at time of expansion and reassessment at time of renovation contain several fundamental weaknesses which preclude their receiving any serious consideration as the basis for implementing market value assessment in Metro Toronto.

5.2 Recommendations

The Sub-Committee on Reassessment Issues therefore recommends to the Metropolitan Toronto Advisory Task Force on Assessment Reform that:

1. **reassessment at time of sale, reassessment at time of expansion and reassessment at time of renovation not be considered as alternatives to the use of Metro wide Section 63 in the implementation of market value assessment in Metropolitan Toronto.**